



Tax Ratios and Tax efforts Indices and their implications for future Tax Reforms & Tax issues in the Shadow Economy

Presentation by:

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Presentation agenda



1. Tax ratios and Tax efforts indices and their implications for future tax reforms
 - a. Tax elasticity
 - b. Tax buoyancy
 - c. Determinants of tax revenue
 - d. Policy implications
2. To understand tax issues in the shadow economy
 - a. Size of the shadow economy
 - b. Corruption and the shadow economy
 - c. Inefficiency and illegality in the shadow economy
 - d. Welfare fraud and Money laundering

- ❑ The Kenyan government has the major aim of stimulating and guiding the economic and social development.
- ❑ The government must therefore increasingly mobilize its own internal resources to achieve this aim.
- ❑ Effective tax policy is the main instrument that can be used to marshal the necessary resources.
- ❑ The government must provide a host of non-revenue yielding services such as education, health, social infrastructure and social security.

Introduction Cont'



- ❑ Average increase in government expenditure have tended to be faster than those of revenue, giving rise to an expanded fiscal deficit.
- ❑ This raises one important question; **How sensitive are yields from various taxes to changes in per capita income?**

Tax Ratios and Tax efforts Indices



- Tax ratio** Measures the ratio of tax revenue to the real GDP
- Tax effort** An index obtained by dividing the actual tax ratio by predicted tax ratio for each year.
- Tax elasticity** Increase in tax ratio as a result of an extension of the tax coverage or revision of the tax rate
- Tax buoyancy** Increase in the tax ratio with the growth of per capita income but without an extension of the tax coverage or an upward revision of the tax rate

Trends in Kenya



- ❑ Since independence, total tax revenue, indirect tax and direct tax ratios has increased moderately.
- ❑ The share of direct taxes in GDP however declined with GDP as compared to that of indirect taxes.
- ❑ This means that the importance of direct taxes as a source of government revenue has been declining over time.
- ❑ The implication is that indirect tax revenue form a high proportion of tax revenue.

Trends in Kenya Cont'



- ❑ The decline share of direct taxes in the total tax revenue can be attributed to the government policy aimed at minimizing the number of law income earners involved in the income tax to achieve fairness and efficiency in taxation.
- ❑ Trends in tax effort indices has generally shown that Kenyans have been over taxed over the years.
- ❑ Over taxation has encouraged tax evasion, avoidance and corrupt practices.

Policy implications-Government



- ❑ Speed up the shift from reliance on direct taxes to indirect taxes especially VAT
- ❑ Exempt SMEs from income tax to allow them to expand and generate more tax revenue in the long run
- ❑ Bring into the tax net lucrative sectors that have grown over the years e.g. NGOs
- ❑ Increase VAT rates on products consumed by high income bracket
- ❑ Broaden tax base and reduce tax rates to enhance compliance by tax payers

Policy implications-KRA



- ❑ Continuously improve tax administration procedure to ensure compliance
- ❑ Enhance tax-payer education
- ❑ Create tax audit capacity
- ❑ Enhance detection capacity and put in place stiffer penalties
- ❑ Enforce Rules and Procedure to induce better tax payer compliance

Policy implications-Tax Payers



- Maintain proper audited accounts
- Comply with tax administration procedure and rules.
- Be honest while filing returns.
- Lobby for provision of tax payer education.
- Lobby for service delivery from the government.
- Lobby for reduction in tax rates on basic commodities.

Tax Issues in Shadow Economy



Shadow Economy

Consist of all unofficial or non-reported economic activities.

Size of the shadow economy

It is estimated on the basis of observed rent, money supply, extent of cash payment and use of electricity.

Corruption and the shadow economy

- ❑ High rate of corruption in government involving large sums of money in form of bribes creates a bigger shadow economy.
- ❑ The people also become reluctant to pay taxes when the government is corrupt, thus increasing the size of the shadow economy.

Tax Issues in Shadow Economy

Cont'



Inefficiency and illegality in the shadow economy

- ❑ There is injustice when unequal opportunity for tax evasion results in discriminatory tax burdens.
- ❑ Activities in the shadow economy provide a cost advantage for producers who don't pay taxes so that honesty is penalized
- ❑ Excessive success of an economic activity in the shadow economy compromises the ability to remain invisible to the tax authorities
- ❑ In the shadow economy, recourse to courts is not available for enforcing contracts and settling disputes (often personal and violent).

Tax Issues in Shadow Economy Cont'



Welfare fraud and Money laundering

- ❑ Welfare fraud occurs when people employed in the shadow economy declares themselves to be officially unemployed and receive an unemployment benefits or welfare payments.
- ❑ Large profits from illegal activities are difficult to spend or invest because tax authorities may ask about the sources of the money thus there is demand for money laundering.

Policy implications-Shadow Economy



- Tax Amnesty.
- Increased probability of detection.
- Enhance tax compliance.
- Confiscation of assets.
- Tax authority auditing every tax return.

END

